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UNCLAS SECTION 01 OF 03 ROME 004923

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SUBJECT: IS ITALYS EXPORT LED GROWTH MODEL IN TROUBLE?

REF: A. ROME 4236

[1](#)B. ROME 2853

[1](#)1. SUMMARY: ITALIAN EXPORTS TO ITS MAJOR MARKETS ARE FACING STIFF COMPETITION FROM, AND LOSING MARKET SHARE TO, CHEAPER EXPORTS FROM ASIA. THE THREAT HAS TRIGGERED MUCH POLITICAL POSTURING IN ITALY, WITH FINANCE MINISTER TREMONTI AND UMBERTO BOSSI, NORTHERN LEAGUE LEADER AND MINISTER OF REFORMS, CALLING FOR A REVIEW OF, IF NOT RETALIATORY ACTION AGAINST, CHINA, INDIA, BANGLADESH, AND PAKISTAN. OTHER PRESSURES SUCH AS THE STRONGER EURO AND SLUGGISH ECONOMIC GROWTH IN EUROPE ALSO ARE AFFECTING ITALIAN EXPORTS, WHICH ALREADY ARE DOWN 2.5 PERCENT THIS YEAR.

[1](#)2. IN THE LONG TERM, ITALY FACES REAL PROBLEMS IN ITS EXPORT SECTOR, WHICH IS THE BACKBONE OF THE ECONOMY AND ACCOUNTS FOR 25 PERCENT OF GDP. THE LIMITED INVESTMENT IN TECHNOLOGY IN THE PAST DECADE HAS PRODUCED A SPECIALIZED, BUT A HIGHLY LABOR-INTENSIVE EXPORT SECTOR, WHICH IS PARTICULARLY VULNERABLE TO COMPETITION FROM COUNTRIES WITH LOW LABOR COSTS. END SUMMARY.

BACKGROUND

[1](#)3. ITALIAN EXPORTS ARE HEAVILY CONCENTRATED IN HIGH-END CONSUMER GOODS, THE DEMAND FOR WHICH IS PARTICULARLY INFLUENCED BY IMPORT PRICE. AS SUCH, THESE PRODUCTS ARE SUSCEPTIBLE TO EXCHANGE RATE FLUCTUATIONS. IN HIS ANNUAL REPORT ON MAY 31, CENTRAL BANK GOVERNOR ANTONIO FAZIO ARGUED THAT THE COMPOSITION OF ITALIAN EXPORTS, DOMINATED BY FURNITURE, LEATHER PRODUCTS AND MANUFACTURED GOODS, MAKES THEM HIGHLY VULNERABLE TO IMPORT PRICE TRENDS (REF B).

POOR PERFORMANCE OF ITALIAN EXPORTS THIS YEAR

[1](#)4. ACCORDING TO THE CENTRAL BUREAU OF STATISTICS (ISTAT), EXPORTS DECREASED BY 2.5 PERCENT, WHILE IMPORTS INCREASED BY 1.8 PERCENT IN THE FIRST SEVEN MONTHS OF 2003 COMPARED WITH THE CORRESPONDING PERIOD IN 2002. THESE TRENDS HAD A DRAMATIC IMPACT ON THE TRADE BALANCE. ITALYS FOREIGN TRADE THROUGH JULY 2003 REGISTERED A 1.6 BILLION EURO DEFICIT, COMPARED TO A FIVE BILLION EURO SURPLUS IN THE CORRESPONDING PERIOD IN 2002. CONFINDUSTRIA, ITALYS LARGEST EMPLOYERS ASSOCIATION, ESTIMATES THAT ITALIAN EXPORTS WILL DECLINE OVERALL BY 1.3 PERCENT THIS YEAR. ITALYS SHARE OF WORLD TRADE IS EXPECTED TO SHRINK, BELOW THE 3.9 PERCENT SHARE IN 2002 AND SIGNIFICANTLY BELOW THE AVERAGE 4.6 PERCENT SHARE IN THE PERIOD 1991-1995.

EXPORTS TO THE EU

[1](#)5. EXPORTS TO EU COUNTRIES (MORE THAN 50 PERCENT OF TOTAL EXPORTS) FELL BY 1.8 PERCENT IN THE FIRST SEVEN MONTHS OF 2003 COMPARED TO THE CORRESPONDING PERIOD IN 2002, WHILE IMPORTS FROM THE EU (ALMOST 60 PERCENT OF TOTAL IMPORTS) INCREASED BY TWO PERCENT DURING THE SAME TIME. TRADE WITH EU COUNTRIES THROUGH JULY 2003 REGISTERED A 3.3 BILLION EURO DEFICIT, COMPARED TO A TWO BILLION EURO DEFICIT REGISTERED IN THE CORRESPONDING PERIOD IN 2002. THROUGH JULY 2003, THE LARGEST DECREASES WERE REGISTERED IN LEATHER AND LEATHER PRODUCTS (DOWN 12.1 PERCENT) AND TEXTILES AND APPAREL (DOWN 8.1 PERCENT).

EXPORTS TO NON-EU MARKETS

[1](#)6. THE PERFORMANCE OF ITALIAN EXPORTS TO NON-EU MARKETS HAS BEEN EVEN WORSE THAN THAT OF EXPORTS TO EU MARKETS. IN THE FIRST NINE MONTHS OF 2003, ITALIAN EXPORTS TO NON-EU COUNTRIES, WHICH INCLUDES THE U.S., TURKEY AND THE FOUR MERCOSUR COUNTRIES, DROPPED BY 3.5 PERCENT, WHILE

IMPORTS INCREASED BY 1.6 PERCENT. THE GREATEST DECLINE WAS IN EXPORTS TO MERCOSUR, DOWN 16.1 PERCENT, TO THE

ROME 00004923 002 OF 003

003 OVER THE CORRESPONDING PERIOD IN 2002. THE STRONGER EURO VERSUS THE DOLLAR IS THE KEY FACTOR BEHIND THE DECLINE IN EXPORTS TO MERCOSUR AND THE UNITED STATES. THESE TRENDS HAD A NEGATIVE IMPACT ON ITALY'S PREVIOUS TRADE SURPLUS WITH NON-EU COUNTRIES. TRADE WITH NON-EU COUNTRIES REGISTERED A 3.5 BILLION EURO TRADE SURPLUS THROUGH SEPTEMBER 2003, LESS THAN A HALF OF THE 7.9 BILLION EURO SURPLUS REGISTERED IN THE CORRESPONDING PERIOD IN 2002.

THE THREAT FROM LOW-COST EXPORTING COUNTRIES

17. ITALY, WITH ITS HIGHLY SPECIALIZED BUT ALSO HIGHLY LABOR-INTENSIVE EXPORT SECTOR, IS VULNERABLE TO COMPETITION FROM COUNTRIES WITH LOW LABOR COSTS, SUCH AS INDIA, BANGLADESH, PAKISTAN, CHINA AND KOREA. WITH RESPECT TO LEATHER AND WOOL PRODUCTS, INDIA AND PAKISTAN NOW EACH HAVE LARGER MARKET SHARES THAN ITALY DOES IN THE GERMAN, FRENCH AND SPANISH MARKETS. MEXICO ALSO NOW OFFERS STIFF COMPETITION IN FURNITURE (CHAIRS AND SOFAS) FOR THE U.S. MARKET.

THE SPECIFIC MENACE FROM CHINA

18. POLITICAL LEADERS IN ITALY ARE POINTING FINGERS AT CHINESE EXPORTS AS THE LEADING CAUSE FOR THE DECLINING MARKET SHARE OF ITALIAN EXPORTS. FINANCE MINISTER TREMONTI RECENTLY DECLARED TO ITALIAN JOURNALISTS: IN THOSE MARKETS WHERE CHINA ENTERS, IT TENDS TO EXCLUDE ITALY. (REF A REPORTS ON THE POLITICAL POSTURING REGARDING THE THREAT FROM ASIA.) MARKET ANALYSTS ALSO ARE BEGINNING TO MAKE SIMILAR OBSERVATIONS. THE EDISON FOUNDATION, A MILAN-BASED INSTITUTE THAT PROMOTES BUSINESS R&D, ARGUES THAT ITALIAN EXPORTS ARE RAPIDLY LOSING MARKET SHARE IN THE EU TO ASIAN AND, IN PARTICULAR, TO CHINESE COMPETITION.

19. EXPORTS FROM CHINA ARE THREATENING ITALY'S MARKET SHARE IN THE EU IN SUCH SECTORS AS KITCHENWARE AND KITCHEN UTENSILS, MANUFACTURED MARBLE AND OTHER STONES, FURNITURE AND FURNITURE PARTS, VALVES, AND LAMPS. IN KITCHENWARE, ITALY'S MARKET SHARE IN THE EU DECREASED FROM 24 PERCENT IN 1990 TO 12 PERCENT IN 2002, WHILE CHINA'S MARKET SHARE INCREASED DRAMATICALLY FROM 3.5 PERCENT OF 1991 TO 37 PERCENT IN 2002. IN THE LAMP SECTOR, FOR EXAMPLE, ITALY'S SHARE IN THE EU MARKET DECREASED FROM 22 PERCENT IN 1990 TO 12 PERCENT IN 2002, WHILE AT THE SAME TIME, CHINA'S MARKET SHARE INCREASED FROM 1.6 PERCENT IN 1990 TO 29 PERCENT IN 2002. EVEN IN SECTORS WHERE ITALIAN EXPORTS HAVE TRADITIONALLY BEEN DOMINANT (E.G., LEATHER SHOES), ITALIAN SHOES FACE STIFF COMPETITION FROM LOWER-COST BUT STILL GOOD QUALITY SHOES MADE IN CHINA AND KOREA. CHINA HAS BECOME THE LARGEST EXPORTER OF SEMI-LEATHER SHOES TO THE U.S. MARKET, AND ITALY'S MARKET SHARE IS NOW LESS THAN ONE THIRD OF THE CHINESE ONE. BUSINESS SOURCES IN THE SOUTHERN ITALIAN REGION OF PUGLIA HAVE COMPLAINED THAT THE REGION'S IMPORTANT SOFA INDUSTRY IS ENTERING A CRISIS PERIOD BECAUSE OF AGGRESSIVE CHINESE COMPETITION. PREVIOUSLY, CHINA HAD BEEN ACTIVE ONLY IN THE LOWER-END SOFA MARKET, BUT IS NOW TAKING OVER THE LUXURY END AS WELL. ONE OF THE REGION'S LARGEST SOFA FACTORIES HAS REPORTEDLY LAID OFF 300 WORKERS AS A RESULT OF FALLING ORDERS.

THE EFFECT ON JOBS

10. GIVEN THE TRENDS, EMPLOYMENT IN THE EXPORT SECTOR HAS DECLINED. PRATO CONFARTIGIANATO, THE CONFEDERATION OF CRAFT ENTERPRISES THAT REPRESENTS 6,000 COMPANIES, INCLUDING 2,800 IN THE TEXTILE SECTOR, CLAIMS THAT ALMOST 500 COMPANIES ARE HAVING DIFFICULTIES AND THAT ALMOST 2,000 JOBS HAVE BEEN LOST IN THE LAST TWO MONTHS. LOCAL PLANTS IN THE TEXTILE DISTRICT OF PRATO IN TUSCANY

ROME 00004923 003 OF 003

S AS REASONS FOR THE JOB CUTBACKS.

OTHER CONCERNS

11. WHILE EXPORTS HAVE TRADITIONALLY BEEN VULNERABLE TO EXCHANGE RATE FLUCTUATIONS, ITALIAN EXPORTERS ARE LOSING A COMPETITIVE EDGE FOR ANOTHER REASON, MANY ECONOMISTS WORRY. ITALY INVESTS ONLY .75 PERCENT OF ITS GDP IN R&D, COMPARED TO AN AVERAGE OF 1.75 PERCENT IN THE EU. THIS LACK OF INVESTMENT IN TECHNOLOGY HAS REDUCED THE

COMPETITIVENESS OF ITALYS EXPORTS AND AGGRAVATED THEIR SENSITIVITY TO EXCHANGE RATE FLUCTUATIONS.

112. IN THE LONGER TERM, ITALYS POLITICAL AND ECONOMIC LEADERS WILL HAVE TO TAKE A HARD LOOK AT ITS EXPORT-DRIVEN ECONOMIC MODEL. EU COMMISSIONER PEDRO SOLBES RECENTLY TOLD ITALYS LEADING BUSINESS DAILY, IL SOLE 24 ORE, THAT HE IS SKEPTICAL ABOUT THE GOVERNMENTS PREDICTION THAT ITALYS EXPORTS WILL INCREASE IN 2004. HE REMARKED THAT IT HAS BEEN A LONG TIME SINCE ITALY WAS ABLE TO HOLD ON TO ITS MARKET SHARES IN EXPORTS, GIVEN THEIR LIMITED ABILITY TO COMPETE ON PRICE. A MORE FAVORABLE EXCHANGE RATE WOULD HELP, BUT LONG-TERM TRENDS ARE NOT ENCOURAGING, HE CONCLUDED.

NOTE: MISSING SIGNATURE.

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2003ROME04923 - Classification: UNCLASSIFIED